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July 8, 1996

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William F. Caton  
Secretary  
Federal Communications Commission  
1919 M Street, N.W. - Room 222  
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

**RE: Ex Parte Notice**  
**CC Docket No. 96-98**

Dear Mr. Caton:

Today, Roy Neel, President and CEO of the United States Telephone Association, led a group of USTA representatives in a meeting with members of the Common Carrier Bureau. In addition to Mr. Neel, the USTA group consisted of Dan Hubbard (SBC); Larry Sarjeant (U S WEST); Bob Blau (BellSouth); Bernie Wunder (Wunder, Diefenderfer, Cannon & Thelen); and Bill Taylor (NERA). Regina Keeney, Richard Metzger, Gregory Rosston, Larry Atlas, Peyton Wynns, Jim Lande, Doron Fertig, Tim Peterson and Tom Koutsky from the Common Carrier Bureau attended the meeting.

The discussion centered on the information contained in the attached charts, which were shared at the meeting. This information is also part of the comments USTA filed today in this docket, and the discussion was consistent with these comments.

An original and one copy of this ex parte notice are being filed in the Office of the Secretary. Please include this notice in the public record of these proceedings.

Respectfully submitted,

A handwritten signature in cursive script that reads "Mary McDermott".

Mary McDermott  
Vice President -  
Legal & Regulatory Affairs

attachments

cc: L. Atlas T. Koutsky G. Rosston  
B. Blau J. Lande L. Sarjeant  
D. Fertig R. Metzger B. Taylor  
D. Hubbard R. Neel B. Wunder  
R. Keeney T. Peterson P. Wynns

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# **The IDSS Model - A Critical Evaluation**

National Economic Research Associates

July 8, 1996

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## Scope of the IDSS Model

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### Determinants of LEC Revenue by Category

End Users	CLEC	IXC
<ul style="list-style-type: none"><li>• Total Bill - Residual</li><li>• Business - Residence</li><li>• Special Access</li></ul>	<ul style="list-style-type: none"><li>• Facilities Based - Unbundled</li><li>• Traditional - CIC Access Rates</li></ul>	<ul style="list-style-type: none"><li>• Bypass</li></ul>

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## **The Model Oversimplifies the Telecommunications Industry**

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- A single aggregate LEC masks different effects on real-world LECs and produces a biased prediction of the total industry effect.
- Does not explicitly model local interconnection or resale of LEC retail services.
- Prices and market shares are not linked.

# Model Contains Numerous Arithmetic and Coding Errors

A					
Panic Expense Reduction part I					0.000
Panic Expense Reduction					0.0%
Base Line Depreciation	0.09854	0.098318	0.098531	0.070871	0.073
Actual Depreciation Rate	0.09854	0.098318	0.098531	0.070871	0.073
Increase in Depreciation	0.278808	0.308289	0.454651	0.448808	0.58
Growth Rate in Other Taxes		1.8%	1.5%	-0.4%	1.0%
Interest Expense as per	3.0%	2.7%	2.6%	2.4%	2.5%
Effective FIT rate	31.0%	32.4%	31.8%	33.1%	33.3%
Shareholders equity as %	48.8%	46.3%	46.6%	45.7%	46.0%
Operating Expense	\$87.9	\$88.0	\$71.2	\$71.2	\$74.4
Annual Depreciation	\$18.1	\$18.6	\$19.3	\$20.3	\$20.3
Operating Profit	\$23.6	\$25.1	\$25.4	\$27.4	\$27.4
year over year changes		64%	11%		-11%
Margin on 'total bill' Toll revenue					\$0.0
Gross Plant worksheet					
Replacement Investment (and special access)	\$12.6	\$13.4	\$12.0		
Refinements offset by new investment	\$10.5	\$11.2	\$8.8		
Net Replacement Investment	\$2.1	\$2.2	\$3.2		
Prior year gross plant	\$272.1	\$282.0	\$291.5		
Investment for net added business lines	\$1.5	\$5.3	\$7.6		
Investment for net added households with serv	\$8.0		\$6.8		
Investment for net added additional residential	\$0.2		\$1.0		
Investment for added minutes hitting LEC switch	\$0.7		\$0.7		
Investment for vertical services	\$2.3		\$0.5		
Investment for Special Access	(\$0.1)	(\$0.1)	\$0.0		
Investment for Private Line services	\$0.1	\$0.0	\$0.1		
Investment for 'other' and Misc. services	\$0.0	\$0.0	\$0.0		
Investment for added toll minutes	\$0.0	\$0.0	\$0.0		
Investment in shadow or stranded loops (to off	\$0.0	\$0.0	\$0.0		

B						
Rate of Return	\$0.0010	\$0.0003	\$0.0088	\$0.0273	\$0.0344	\$0.0232
Residential Rate Index	\$9.8	\$9.4	\$9.7	\$9.0	\$7.5	
Basic + SLC	\$98.7	\$91.5	\$91.9	\$94.2	\$97.0	\$99.8
Rate & Interest	\$19.7	\$20.4	\$19.9	\$20.7	\$20.9	\$21.8
Unbundled	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
All other op.	\$18.3	\$18.7	\$20.1	\$20.5	\$21.0	\$21.4
LEC high co	\$0.7	\$0.7	\$0.7	\$0.7	\$0.7	\$0.7
Total LEC R	\$97.7	\$100.7	\$101.8	\$105.4	\$108.8	\$112.9
Total Expan	\$71.2	\$71.7	\$74.4	\$78.7	\$78.3	\$80.0
Net Rate B	\$167.3	\$167.7	\$167.7	\$176.5	\$188.9	\$192.9
Rate of new	12.5%	14.0%	14.1%	14.2%	13.7%	
% lines lost	0.0%	0.0%	0.0%	0.0%	0.0%	
% lines lost	0.0%	0.0%	0.0%	0.0%	0.0%	
Traditional	375.6	491.2	439.8	488.3	500.0	545.8
Theoretical	375.6	491.2	439.8	488.3	500.0	545.8
Investment in	375.6	491.2	439.8	488.3	500.0	545.8
LEC/ECOT	44.8388	48.0884	48.0885	51.5483	55.89821	58.948973
Total Loops	147.0855	182.4294	188.373	194.0911	170.0888	178.304942
EC/Loops	182.4294	188.373	194.0911	170.0888	178.304942	
Residential customers unbundled loops	0.000	0.000	0.000	0.000	0.000	0.000
LEC/ECOT	0.000	0.000	0.000	0.000	0.000	0.000
Total "All LEC" customers	0.000	0.000	0.000	0.000	0.000	0.000
Total "proprietary" households	0.000	0.000	0.000	0.000	0.000	0.000
Targeted as a percent of total house	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Toll minutes billed to customers (billions)						
on residual customer lines		104.911	112.898	123.245		
on CLEC lines		0.000	0.000	0.000		
on LEC total bill lines		0.000	0.000	0.000		
Total		104.911		123.245		
on LATA Interstate						
on residual customer lines		35.085		41.828		
on CLEC lines		0.000		0.000		
on LEC total bill lines		0.000		0.000		
Total		35.085		41.828		

C					
Net Cost Assessment					
Additional LEC marketing Expense when unbundled loops > 10%					
Residential					\$0.0
Business					\$0.0
Additional LEC marketing expense when they go into D/C markets					
Residential					\$0.0
Business					\$0.0
Inflation in the whole eco	0.030	0.028	2.6%	2.3%	2.5%
Special LEC productivity adjustment					-2.0%
D/C annual productivity reflected in rates					-3.0%
Expense, Plant and Income Data (Billions)					
Annual Depreciation	\$18.1	\$18.6	\$19.3	\$20.3	\$21.7
Other LEC Operating Exp	\$49.8	\$49.5	\$51.9	\$51.4	\$52.7
Total LEC Operating Exp	\$67.9	\$68.0	\$71.2	\$72.4	\$74.4
Earnings Before Interest	\$23.6	\$25.1	\$25.4	\$27.4	\$27.4
Interest and related item	\$4.8	\$4.5	\$4.3	\$4.1	\$4.1
Other Taxes (should be, when)	\$4.7	\$4.8	\$4.8	\$4.9	\$4.9
Income & Related Taxes	\$4.4	\$5.1	\$5.1	\$5.3	\$5.1
After Tax Profit	\$0.7	\$10.7	\$11.1	\$12.6	\$12.3
LEC Gross Plant (Acct)	\$283.7	\$272.1	\$320.0	\$391.5	\$303.4
Accumulated Depreciat	\$100.2	\$105.9	\$114.7	\$123.6	\$135.7
LEC Net Plant (Acct 35)	\$183.5	\$166.2	\$167.3	\$167.7	\$167.7
Total other liabilities and	\$39.2	\$40.9	\$46.3	\$51.9	\$50.8
Rate Base	\$125.3	\$125.2	\$121.0	\$115.8	\$116.8
EBITDA (Earnings before interest, taxes, depreciation					
& amortization	\$41.70	\$43.67	\$44.63	\$48.01	\$49.09
LEC Shareholder Equity	\$81.50	\$81.89	\$77.99	\$76.65	\$77.13
Rate of return on Model Rate B	12.1%	12.5%	14.0%	14.1%	
Return on Equity	11.9%	13.1%	13.8%	16.3%	15.9%

## Model is Sensitive to Assumptions with a High Level of Uncertainty

Unknowable Fact	Change in Assumption and Resulting Effect on EBITDA
Spec 26 -- Business Local Rates First Year of CLEC Competition	A decrease of 10% from -2.6% results in a loss of <b>\$1.5 billion</b> for the LEC.
Spec 73 -- % CLEC Loops Provided With CLEC's Own Facilities	An increase of 20% results in a decrease in LEC earnings of <b>\$5.6 billion</b> .
Specs 79 and 80 -- Percent of LEC "Total Bill" Customers	An increase of 10% starting in 1997 increases LEC earnings by <b>\$6 billion</b> .
Specs 117 and 118 -- Total added LEC marketing expense when unbundled loops exceeds threshold: Residence and Business	An increase of \$5 billion results in a <b>\$10.6 billion</b> decrease in LEC earnings.
Specs 119 and 120 -- Total added LEC marketing expense if LEC share of "total bill" customer loops exceeds threshold: Residence and Business	An increase to \$5 billion from \$0 results in a <b>\$10.8 billion</b> decrease in LEC earnings.
Base Case is the n/e/r/a base case. All changes in earnings are based on EBITDA for the year 2006.	

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## **...but the Model Shows Substantial Impact of Potential Policy Decisions**

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- Base Case: Local and interstate toll competition in 1997 with reasonable interconnection policies.
  - Scenario 1: Cheap interconnection, resale and unbundled loops.
  - Scenario 2: Same as Scenario 1 with bypass of terminating access.
  - Scenario 3: CLEC purchases all network elements at low TSLRIC.
  - Scenario 4: Same as Scenario 3 with bypass of terminating access.
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**Figure 1: Predicted Loss in LEC Lines from the Base Case**

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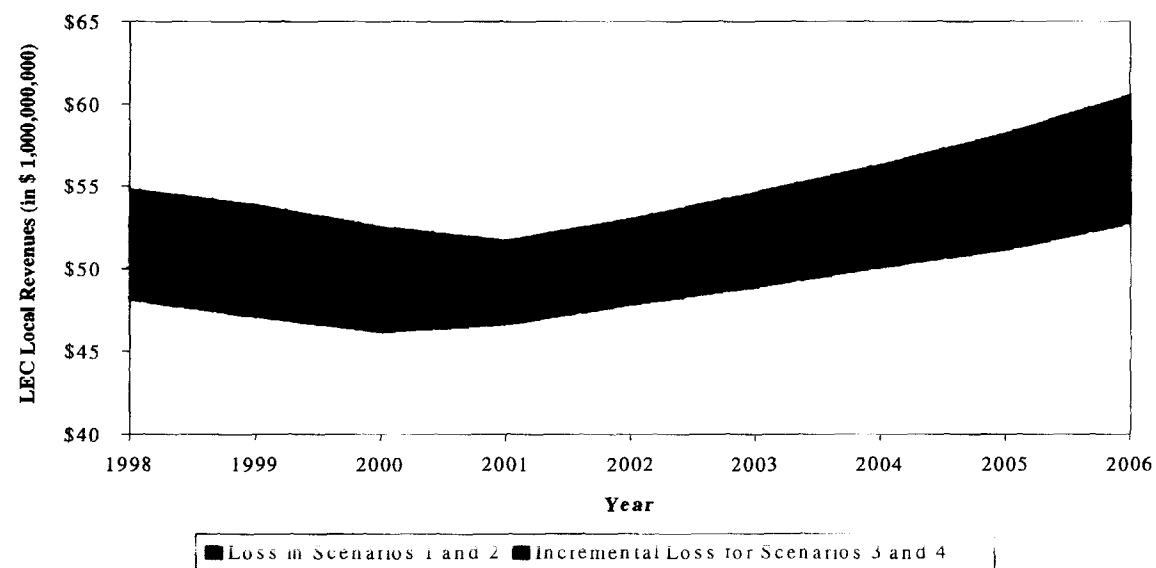




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**Figure 2: IDSS Forecast Changes in LEC Local Revenues from Base Case**

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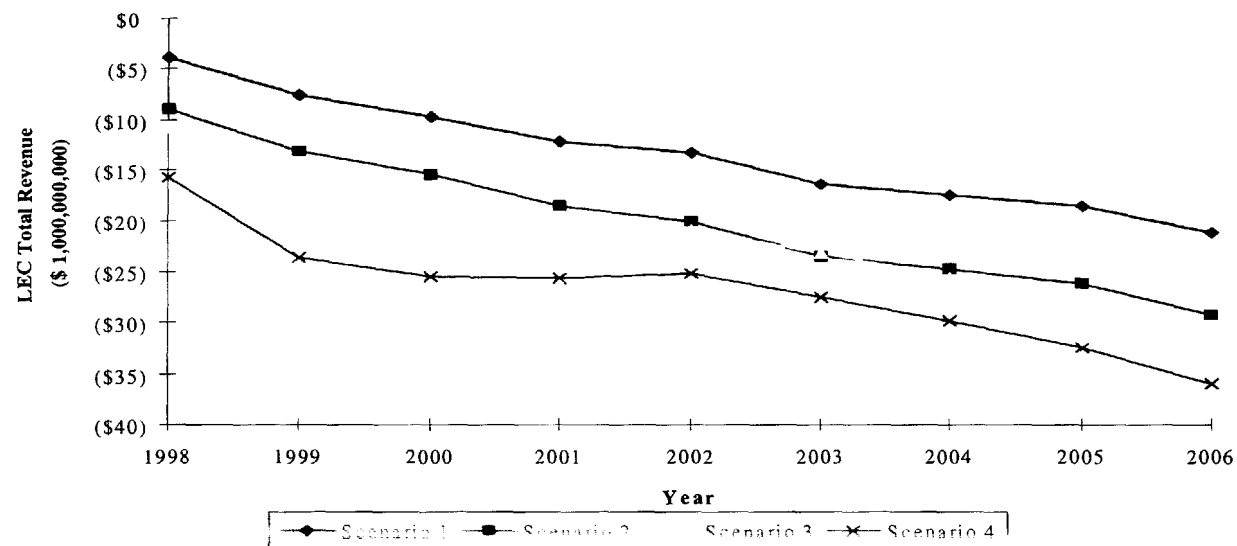
## Figure 3: IDSS Predicted LEC Toll Revenue Losses from Base Case



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**Figure 4: IDSS Predicted LEC Total Revenue Losses from the Base Case**

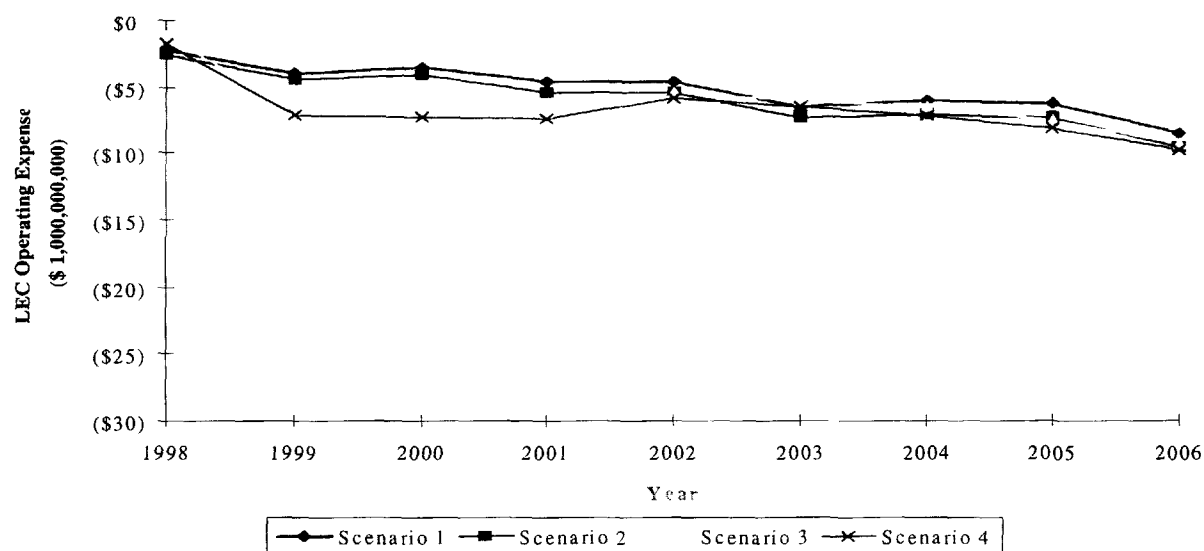
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**Figure 5: IDSS Predicted Difference in LEC Operating Expense from Base Case**

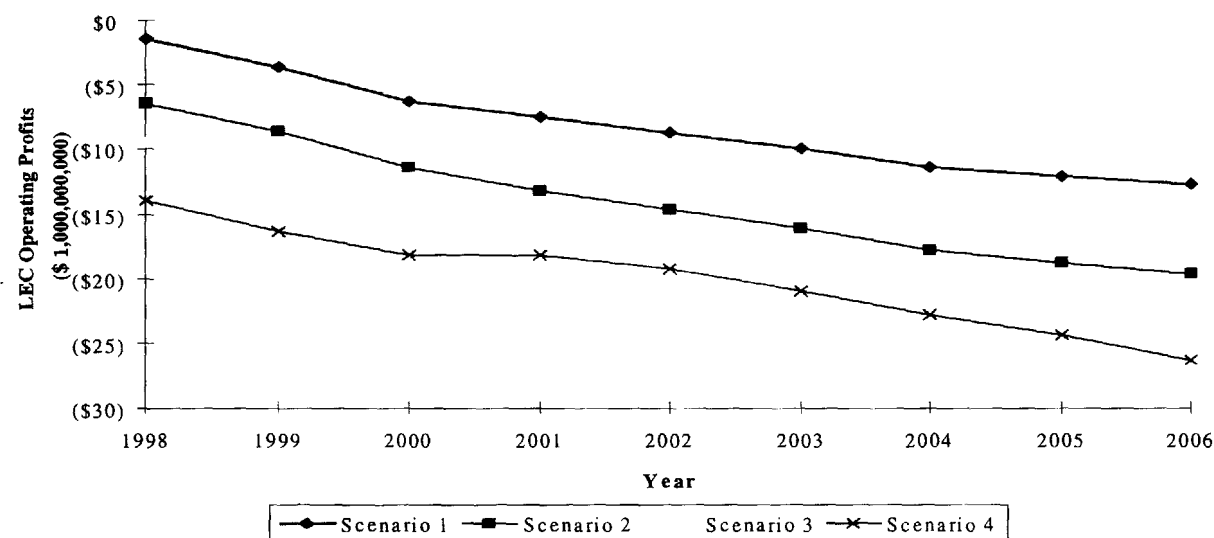
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**Figure 6: IDSS Predicted Difference in LEC Operating Profits from the Base Scenario**

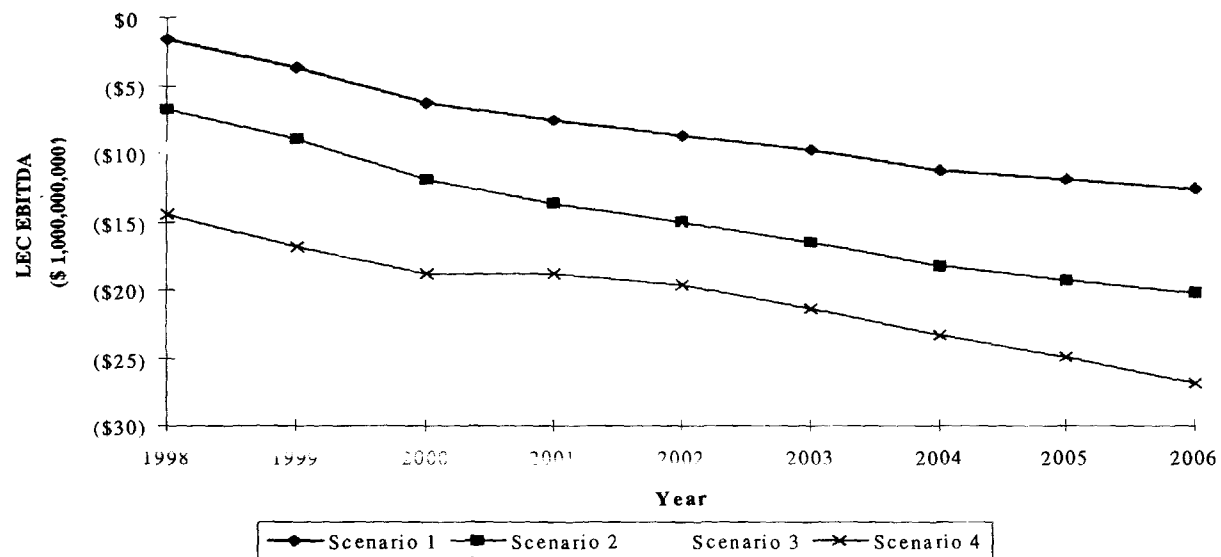
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**Figure 7: IDSS Predicted Losses in LEC EBITDA from the base case**

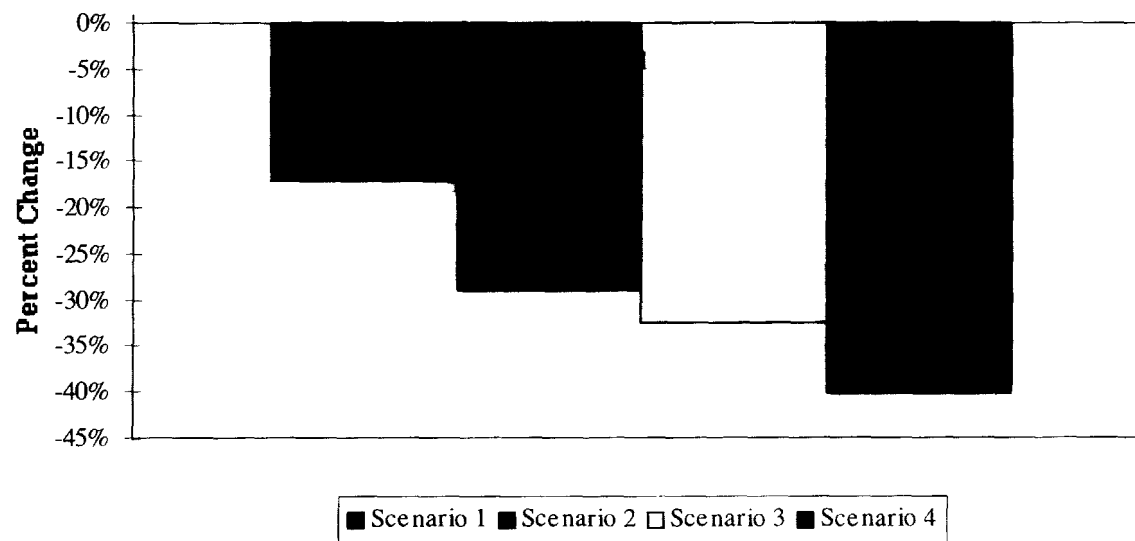
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**Figure 8: Potential Decline in LEC Equity Value from Base Case**

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**Figure 9: IDSS Predicted Loss in Revenue per Line from the Base Case**

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